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In the Supreme Court of the United States

OCTOBER TERM, 1990

SHELDON BARUCH TOIBB, PETITIONER

v.

STUART J. RADLOFF

**ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT**

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether a debtor must be engaged in an ongoing business in order to seek reorganization relief under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101 *et seq.*

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BRIEF FOR THE RESPONDENT

This brief is filed in response to the Court's letter dated October 26, 1990, requesting James S. Cole, Assistant United States trustee, to file a response to the petition.¹

OPINIONS BELOW

The opinion of the court of appeals, Pet. App. A2-A6, is reported at 902 F.2d 14. The opinions of the district court, Pet. App. A9-A16, and the bankruptcy court, Pet. App. A19-A28, are unreported.

¹ The United States trustee did not participate in the proceedings below. His status as a respondent is authorized by 11 U.S.C. 307, which provides that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding under this title * * *." Alternatively, this brief may be viewed as one filed by the United States as *amicus curiae*.

JURISDICTION

The judgment of the court of appeals was entered on May 2, 1990. A petition for rehearing was denied on June 8, 1990. Pet. App. A7. The petition for a writ of certiorari was filed on August 2, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

The Bankruptcy Code offers debtors different remedies under its different Chapters. For example, Chapter 7 of the Code authorizes liquidations; Chapter 11, reorganization; and Chapter 13, adjustment of the debts of an individual with regular income. Most debtors qualify for relief under more than one Chapter. The debtor's choice of a particular Chapter is determined by the cost of its proceedings and the scope of relief it provides.²

In this case, petitioner—an individual debtor—sought to reorganize under Chapter 11. The bankruptcy court dismissed his petition on the authority of *Wamsganz v. Boatmen's Bank of De Soto*, 804 F.2d 503 (8th Cir. 1986), which held that “persons not engaged in business may not seek relief under Chapter 11 of the Bankruptcy Code.” *Id.* at 505. The district court and the court of appeals affirmed the dismissal on the same basis.

1. Beginning in March 1983, petitioner was employed as a consultant by the Independence Electric Corporation (IEC)—a company formed in 1983 to produce and market electric power. IEC terminated petition-

² For a brief survey of some of the factors that may enter into this complex decision, see Herbert, *Consumer Chapter 11 Proceedings: Abuse or Alternative?*, 91 Com. L.J. 234, 239-240 (1986).

er's consulting agreement in April 1985. Between April 1985 and September 1986, petitioner sought other consulting work related to the energy industry, with little success. He relied primarily on income from his parents and friends and from payments related to his previous consulting work at IEC. In July 1986, petitioner moved to St. Louis, Missouri. On November 18, 1986, he filed a voluntary Chapter 7 (liquidation) petition in the United States Bankruptcy Court for the Eastern District of Missouri. Pet. App. A19-A22.

On October 2, 1987, petitioner was permitted to convert his Chapter 7 petition to one under Chapter 11 (reorganization). On March 8, 1988, however, the bankruptcy court *sua sponte* entered an order directing petitioner to show cause why his petition should not be dismissed for failure to qualify as a Chapter 11 debtor. After a hearing, the bankruptcy court found that petitioner was not engaged in an ongoing business³ and, in view of the holding in *Wamsganz v. Boatmen's Bank of De Soto*, *supra*, that Chapter 11 is limited to business debtors, dismissed the petition. Pet. App. A19, A24-A25, A27-A28.

2. On appeal, the district court found no basis to disturb the bankruptcy court's finding that petitioner

³ The bankruptcy court found that petitioner was not engaged as an energy consultant on the date he converted his Chapter 7 petition to one under Chapter 11 or at any time thereafter. Pet. App. A25. Although petitioner also contended that he was engaged in the business of raising funds for nonprofit organizations, the bankruptcy court determined that petitioner's “fund raising endeavors comprise only a temporary occupation and do not constitute the ‘business’ which the Debtor is seeking to reorganize.” *Ibid.* Petitioner does not seek review of the question whether he is engaged in an ongoing business. Pet. 7 n.1.

"was not engaged in an ongoing business" and affirmed that court's dismissal of petitioner's case on the authority of *Wamsganz*. Pet. App. A16. In a brief *per curiam* opinion, the court of appeals likewise concluded that petitioner "did not qualify as a business entitled to Chapter 11 protection" and that "the Bankruptcy Court was controlled by *Wamsganz*." *Id.* at A5. The petition to rehear the case en banc was denied. *Id.* at A7.

DISCUSSION

The courts of appeals disagree whether a debtor must be engaged in an ongoing business to be eligible for relief under Chapter 11 of the Bankruptcy Code. Although no statistics report the number of non-business debtors who seek relief under Chapter 11, an analysis of lower court decisions suggests that the number may be significant. Because non-business debtors typically lack the means (and their creditors the financial motivation) to litigate before this Court, this case presents an appropriate and unusual opportunity to achieve uniformity on this important issue throughout the circuits.

1. The decision of the Eighth Circuit below rests on its earlier decision in *Wamsganz v. Boatmen's Bank of De Soto*, 804 F.2d 503 (1986), which disagreed with the decision of the Eleventh Circuit in *In re Moog*, 774 F.2d 1073 (1985) (*per curiam*). In *Wamsganz*, the Eighth Circuit acknowledged that "Chapter 11 contains no explicit limitation excluding persons not engaged in business," 774 F.2d at 504, but nonetheless held that a married couple not engaged in a business could not seek relief under Chapter 11 because the "legislative history of the Bankruptcy Code, taken as a whole, shows that Congress meant for chapter 11 to be available to businesses and persons engaged in business, and not to consumer debtors," *id.*

at 505.⁴ The Eighth Circuit declined to reconsider *Wamsganz* in this case. Pet. App. A5, A7.

The Eighth Circuit in *Wamsganz* rejected the analysis of the Eleventh Circuit in *In re Moog*, 774 F.2d 1073 (1985) (*per curiam*). 804 F.2d at 505. The Eleventh Circuit in *Moog* held that although "Chapter 11 is primarily aimed at business debtors, consumer debtors might find Chapter 11 appropriate under certain circumstances." 774 F.2d at 1074. It noted that Section 109(d) of the Bankruptcy Code, 11 U.S.C. 109(d)—which identifies the debtors eligible for relief under Chapter 11—does not require operation of an ongoing business. 774 F.2d at 1075. Instead, Section 109(d) provides that a Chapter 11 debtor may be anyone who may proceed under Chapter 7, and with exceptions not relevant here, Chapter 7 is available to any person other than a railroad or specified financial institution. See 11 U.S.C. 109(d). The Eleventh Circuit also relied on the following passage from a committee report discussing Chapter 11:

⁴ The Eighth Circuit cited the decisions of the Fifth and Sixth Circuit Courts of Appeals for the proposition that "persons who are not engaged in business may not seek relief under chapter 11" of the Bankruptcy Code. *Wamsganz*, 804 F.2d at 503 (citing *In re Little Creek Development Co.*, 779 F.2d 1068 (5th Cir. 1986) and *In re Winshall Settler's Trust*, 758 F.2d 1136 (6th Cir. 1985)). *Little Creek* and *Winshall Settler's Trust*, however, were not filed by individual debtors hoping to persuade the bankruptcy court that they should be permitted to retain assets by pledging future nonbusiness income. Although *Little Creek* and *Winshall Settler's Trust* differ from the Eleventh Circuit's approach, the Fifth and Sixth Circuits were not called upon to answer the precise question presented here. See *In re Markunes*, 78 Bankr. 875, 879 (Bankr. S.D. Ohio 1987) (*Winshall* does not prohibit Chapter 11 relief to a non-business debtor).

Chapter 11, Reorganization, is primarily designed for businesses, although individuals are eligible for relief under the chapter. The procedures of chapter 11, however, are sufficiently complex that they will be used only in a business case and not in the consumer context.

S. Rep. No. 989, 95th Cong., 2d Sess. 3 (1978); see *Moog*, 774 F.2d at 1074. As the Eleventh Circuit observed, the Senate Report expressly recognizes that non-business debtors are eligible for relief under Chapter 11. *Ibid.*⁵

2. The conflict between the Eighth and Eleventh Circuits over the availability of Chapter 11 relief to non-business debtors is of sufficient practical importance to warrant review by this Court. Although no statistics report the number of non-business debtors who seek relief under Chapter 11,⁶ the reported decisions of the lower courts suggest that such debtors do so with some frequency. Compare, *e.g.*, *In re*

⁵ The Eleventh Circuit also observed that Chapter 11 was designed to bring together into one type of proceeding those cases that had been eligible for reorganization under Chapters X, XI, and XII of the Bankruptcy Code of 1898, which had been available to individuals. 774 F.2d at 1075. In addition, the Eleventh Circuit noted that Official Form No. 7, which is a financial statement form for a debtor not engaged in business, is expressly referenced for possible use in Chapter 11 proceedings under Bankruptcy Rule 1007(b). *Ibid.*

⁶ The 1989 *Annual Report of the Director of the Administrative Office of the United States Courts* counts 1,986 "non-business filings" under Chapter 11 of the Bankruptcy Code for the twelve months ending June 30, 1989. *Id.* at 362. The Report does not make clear whether this figure includes filings by individual non-business debtors or filings by all individuals (whether or not they are engaged in an ongoing business).

Bryan, 104 Bankr. 554, 558-559 (Bankr. D. Mass. 1989) (allowing non-business petition under Chapter 11); *In re Cook*, 98 Bankr. 624, 626 (Bankr. D. Mass. 1989) (same); *In re Silverstein*, 94 Bankr. 284, 289 (Bankr. E.D.N.Y. 1988) (same); *In re McStay*, 82 Bankr. 763, 767 (Bankr. E.D. Pa. 1988) (same); *In re Fernandez*, 97 Bankr. 262, 263 (Bankr. E.D.N.C. 1989) (same); *Grundy National Bank v. Shortt*, 80 Bankr. 802, 805 (W.D. Va. 1987) (same); *In re Gregory*, 39 Bankr. 405, 409 (Bankr. M.D. Tenn. 1984) (same); *In re Markunes*, 78 Bankr. 875, 879 (Bankr. S.D. Ohio 1987) (same), with *e.g.*, *In re Ponn Realty Trust*, 4 Bankr. 226, 231 (Bankr. D. Mass. 1980) (dismissing non-business petition under Chapter 11); *In re Bendig*, 74 Bankr. 47 (Bankr. D. Conn. 1987) (same); *In re Lange*, 75 Bankr. 154 (Bankr. N.D. Ohio 1987) (same); *In re Roland*, 77 Bankr. 265 (Bankr. D. Mont. 1987) (same).

It is true that a non-business debtor's Chapter 11 petition, like any other, may be dismissed for "cause" under 11 U.S.C. 1112(b), and that the absence of an ongoing business will often constitute "cause" for believing that the debtor cannot effectuate a reorganization under 11 U.S.C. 1112(b)(2). But the notion that reorganization plans supported by an ongoing business are more likely to be viable than are plans without such support is no reason to deny Chapter 11 reorganization to all non-business debtors. In many cases, an individual debtor will be able to pledge non-business assets or income to fund a viable plan. Compare *Moog*, 774 F.2d at 1075, with Pet. App. A26-A28. Moreover, if speculation that a class of debtors is unlikely to succeed were sufficient warrant to deny reorganization relief, then *no* debtor should be en-

titled to proceed under Chapter 11 because also 90% of such reorganization attempts fail.⁷

While the number of persons potentially affected by this issue is large, the number of cases presenting it to this Court is not. Non-business debtors, by definition, are litigants with only marginal means. Not many will be in a position to appeal the dismissal of their Chapter 11 petitions for lack of an ongoing business. By the same token, it will be unusual that a disgruntled creditor will have enough at stake to appeal the denial of a dismissal in this context.

3. At the same time, and perhaps for the same reasons, it must be noted that the progress of this case to this Court has been somewhat unusual. The bankruptcy court dismissed petitioner's Chapter 11 petition *sua sponte*. Although the United States trustee was served with petitioner's briefs, he did not oppose petitioner's appeals of the dismissal of his case. Nor did any creditor defend the bankruptcy court's dismissal. In sum, no adversary proceedings were held before the district court or the court of appeals.

The federal government—the only respondent before this Court, see p. 1 & note 1, *supra*—is of the view that the lower courts erred in concluding that Chapter 11 is limited to debtors engaged in an ongoing business. Section 109 of the Bankruptcy Code,

⁷ Eighty-three percent of cases filed under Chapter 11 do not result in a confirmed plan; of the 17% that do, only two-thirds of those cases (or 11% of the total) achieve successful reorganizations. E. Flynn, *A Statistical Analysis of Chapter 11* (Oct. 1989) (unpublished study conducted by the Bankruptcy Division of the Administrative Office of the United States Courts).

which defines those debtors eligible for Chapter 11 relief, does not exclude non-business debtors. The legislative history supports the natural inference to be drawn from the silence of the statute. The Senate Report expressly recognizes that non-business debtors "are eligible for relief under the chapter." S. Rep. No. 989, *supra*, at 3. The legislative history collected by the Eighth Circuit in *Wamsganz*, 804 F.2d at 505, merely reflects the anticipated function of Chapter 11 as a "single chapter for all business reorganizations," S. Rep. No. 989, *supra*, at 9, and Congress' expectation that the expense and complexity of Chapter 11 proceedings would discourage non-business debtors. It does not foreclose Chapter 11 relief for non-business debtors.

CONCLUSION

We believe that the question presented warrants this Court's review, in light of the conflict between the Eighth and Eleventh Circuits and the frequency with which the issue appears to arise. At the same time, only two courts of appeals have ruled on the issue, and the total lack of adversary proceedings below—and the absence of any party supporting the judgment before this Court—may counsel in favor of awaiting another case presenting the question. If the Court does decide to grant review, it might wish to appoint counsel to defend the judgment below. *Mathews v. Weber*, 423 U.S. 261, 265 n.2 (1976); *Granville-Smith v. Granville-Smith*, 348 U.S. 885, 885-886 (1954), 349 U.S. 1, 4 (1955).

Respectfully submitted.

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